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SUBJECT: POLITICAL PROBLEMS EFFECT ON THAI ECONOMY

REF: A. BANGKOK 788 (THE FREAT THAKSIN ASSET SALE)

[B](#). BANGKOK 551 (MEGAPROJECTS CONFERENCE)

[C](#). 05 BANGKOK 7000 (EXPORTS REVIVE THAI ECONOMY)

[1](#)1. (SBU) Summary and Introduction. It has been less than two months since the news that the Prime Minister's publicly-listed holding company, Shin Corp, was to be bought by Temasek of Singapore. This event catalyzed opposition to Thaksin and has led to almost two months of political uncertainty. With this limited timeframe, there is little hard data to judge the effect of the political situation on the economy nor to separate out economic declines attributable to the end of a business cycle from reaction to political concerns. Nevertheless, following a series of discussions with foreign and Thai businesspeople, economists, market analysts and government economic officials we believe that in the short term the economy will whether this storm achieving positive GDP growth albeit at a rate up to 2 percent slower than if the political situation were stable. If the current political instability persists for more than another three months, however, the effects could be more severe and long-lasting. End Summary and Introduction.

FDI Down but Not Out

[1](#)2. (SBU) Anecdotal evidence indicates that companies with existing operations in Thailand have proceeded with planned additional investment thus far in 2006. This is especially true of Japanese companies which had been preparing to expand their Thai operations in conjunction with a Thai-Japan FTA (awaiting final signature) and of some foreign-owned manufacturers whose Thai output is primarily for export. We understand that investors that had been considering an initial investment into Thailand are taking a 'wait-and-see' approach. We believe the overall effect on FDI so far is minimal but, as prognosticators here continually point out, if the political uncertainty lasts more than a few more months FDI could dry up. In 2005, the Bank of Thailand reported FDI of US\$ 2.7 billion, 1.5 percent of 2005 GDP and a 223 percent increase over 2004 (a year which some substantial disinvestment). Foreign portfolio investment was very strong the first two months of 2006. Foreign portfolio managers reportedly had an excess of cash, were fully invested in other Asian markets and underweighted in Thailand, and with the Thai market selling at a price/earnings ration of about 9 vs. 12-13 for the rest of Asia found the Thai market too attractive to ignore. These managers and most economists point out that the issue in Thailand is political, not economic, and therefore expect economic conditions to improve as soon as the political situation is resolved. Over the past week or so, foreigners have stopped adding to their portfolios here as they bought to their targeted levels. There are no signs indicating that they are exiting the market.

Thai Investors on Hold

[1](#)3. (SBU) The available evidence so far points to a marked slowdown in domestic investment. Banks have told us that their corporate loan growth is very slow and preliminary customs figures reportedly show imports of capital goods declining. Meanwhile capacity utilization, especially in export sectors, is reportedly up to 90 percent. Exacerbating Thai business reluctance to invest is that the much-anticipated "megaprojects" (a multi-billion dollar, 5-year infrastructure development program) that had been expected to begin by now is indefinitely on hold pending resolution of the political impasse. One reason Thaksin had promulgated the megaproject program was to stimulate private investment and counteract the negative effect of slowing consumer demand.

[1](#)4. (SBU) One analyst attributed the slowdown in investment directly to political uncertainty: "the businessmen don't know who to pay for contracts anymore." A reflection of how important this aspect of doing business here is; none of the

major business organizations have taken a public position on the political situation - a reflection of divided membership but also a desire not to be seen as backing the wrong horse. There are voices in the business community arguing that their businesses are suffering and pleading for a quick political settlement, including one of the vice-chairs of the Federation of Thai Industries - one of the countries major business associations. But we were told by the secretary general of another business group that there is no way they will take a public stand favoring one side or the other in the political battle.

15. (SBU) Demand for new housing units reportedly remains strong at the luxury-end of the market although slower in the rest of the market. Applications for new construction are down 31 percent from the same period last year. This is probably as much a function of the real estate cycle as any other factor. Thais have been liquidating holdings in the Thai stock market and buying bank CDs (as reflected in decreasing loan/deposit ratios) and government debt. The SET Index is down about 3.5 percent from its 2006 high, but still trading significantly above the levels of the second half of 2005.

Consumers Wary

16. (SBU) As previously reported (reftels), domestic consumption was expected to slow this year in the wake of high consumer debt levels, rising interest rates (up 125 basis points over the last 12 months) and inflation which ran at 6.1 percent in 2005 (5.6 percent February 2006). While new car sales were reported strong in January and February, some analysts argue that this is a reflection of new model introductions and accounting practices which pushed sales into the new year from December rather than particularly strong underlying demand. Travel agents report a slowdown in their Thai outbound business. Preliminary customs reports are said to show a slowing of imports of consumer goods.

The Bottom Line

17. (SBU) There is no panic and no evident slowdown of economic activity in Bangkok. That said, everyone with whom we have spoken believes a slowdown in investment and consumer activity is occurring and will worsen if the current political instability lasts more than a few months longer (the consensus is June, for no apparent economic reason but because of concern that if things aren't resolved in time for the King's 60th anniversary of his coronation, then things must be really bad.) The expectation is that events to date will reduce 2006 GDP by 0.5 - 1 percent (resulting in 4-5 percent growth for the year). However, if the situation persists, GDP could grow by as little as 3 percent.

18. (SBU) There is clearly no flight from the baht. The Thai currency has continued to perform well this year (down 0.6 percent against the US\$) and official foreign exchange reserves have increased to US\$54.5 billion from US\$52.1 billion in December. While some of this strength is attributable to US\$1.8 billion inflow from Temasek to fund their purchase of Shin Corp and foreign portfolio investment inflows, there is no evidence of significant outward currency flows. Analysts attribute this vote of confidence to several factors:

- Thais are naturally optimistic and are confident that, somehow, all the political issues will be resolved; "don't forget, we always have the King to settle matters if things get too out of hand" one analyst told us.
- The export sector is "unaffected" by all these problems. Thai analysts are generally confident that so long as the world economy stays healthy, the Thai economy can continue to grow in its wake.
- "We are non-violent people, so tourists will continue to visit." "Tourists came back after the tsunami, so they will not be put off by demonstrations no different than they have in their home countries."
- "Our economy has survived many problems; we can survive this one too."

A Comment about Taxes, Demographics and Street Protests

19. (SBU) Septel will examine the structure of the Thai tax system and its effect on the economy. But we note here that the failure of the PM to pay any tax on his US\$1.8 billion capital gains has been a major source of anger among the Bangkok middle class and business people. Thailand's salaried employees are the only Thais who pay personal income tax and while this group has increased rapidly with Thailand's industrial development, such tax payers still number only 4 million of Thailand's 64 million population, and the vast majority of these 4 million live in Bangkok. Rural people typically earn below the minimum taxable income of Bt80,000 (US\$2048) per year and usually operate outside the formal

economy in any case. Since Thaksin took office, he has modernized the Revenue Department and made them far more efficient tax collectors. Although most of their efforts have gone to better collection of corporate taxes, they have also improved collection of personal income taxes mostly through payroll withholding. The very wealthy, especially the owners of businesses, pay minimal income tax because most of their personal expenses are borne by their companies which write off the costs as business expenses. This sense that the rich "Thaksin cronies" and Thaksin's rural support base (who receive the benefit of better tax collection through debt write-offs, almost-free hospital visits and other redistributive policies) are free riders tax-wise has been an additional impetus for Bangkok middle class people to take to the streets to oust the PM.

BOYCE